Supreme Court, U.S.
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No. 92-1332

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

CAPTRAN CREDITORS' TRUST, CLUB BAHA, LTD. and TROPICAL PROPERTIES, LTD.,
Petitioners,

v.

DAVID W. MCCONNELL, GERALD A. MCHALE, JR. and MCHALE, EZZELL & CO., P.A.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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REPLY BRIEF

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Petitioner will not burden the Court with a detailed analysis of Respondents' factual presentation. Suffice it to say that this presentation is simply shot through with factual errors, as evidenced by the following three examples:

1. Respondents state that "Count II alleged professional negligence against McHale and McConnell" (p. 2). In fact, and importantly, Count II of the Amended Complaint included charges against McHale, McConnell *and* "McHale, Ezzell & Co., P.A."

2. Respondents state that "Contrary to the Petition's attempted implication at p. 3, McHale was not engaged as

a CPA by Club Baha during his tenure as Co-Trustee, neither was the P.A. in any way a Co-Trustee" (p. 6). In fact, the record demonstrates beyond question that McHale had been retained as a CPA by Club Baha (*see* R-1-4 [T]-1398, 1434, 1435, 1536; R-1-4 [TF]-86). In one letter, for example, he conceded that he had been appointed "primarily to act as a representative agent for Tropical Properties, Inc. and Club Baha Limited," and he signed the letter, "Gerald A. McHale, Jr., Certified Public Accountant" (R-1-4 [P]-12, p. 6).

3. Respondents argue that certain closings "were prevented by Grobowsky's refusal to release Club Baha's judgment lien in the state court action" (p. 7 n.5). But the record shows that *McHale* advised Grobowsky and Club Baha not to release the lien, and that even if the lien had been released, no unsecured creditor would have received anything, since two financial institutions had higher priority liens (R-1-4 [P]-43; R-1-4 [T]-1092).

We cite these examples only to demonstrate that Petitioner's recital of the facts was entirely accurate, and that the Court cannot rely upon any part of Respondents' presentation of those facts.

Of more importance is Respondents' treatment of the law. Petitioner has already demonstrated that the District Court misconstrued several of the Bankruptcy Court's key findings and rulings. No further argument is needed on this score, because this Court can read the two opinions and draw its own conclusions. Moreover, little need be said about Respondents' contention that exculpatory clauses in general are not necessarily against public policy. Petitioner has never claimed that they are. Petitioner's position has always been that this particular exculpatory clause, that allows recovery *only* for "proven dishonesty," is so clearly against federal public policy as to require this Court to strike it down.

The one point in the Brief in Opposition that does require further comment, however, is Respondents' contention that the issues in this case, including the legality of the exculpatory clause, are "controlled solely by state law" (p. 12). The Court will note that Respondents do not cite a single case, state or federal, for this important conclusion. The reason is obvious.

First, we would remind the Court of how the exculpatory clause came into play. CRI filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Soon thereafter, CRI and some of its largest creditors, including Club Baha and Tropical properties, entered into extensive negotiations, the purpose of which was to satisfy CRI's creditors and to resolve CRI's problems outside the provisions of Chapter 11 and the Bankruptcy Court. The negotiations resulted in the Captran Creditors Settlement Agreement. In 1985, parties claiming to be CCT creditors filed an involuntary bankruptcy petition against the trust. That filing held up the plans to transfer the CCT assets to Club Baha. The Bankruptcy Court ruled that CCT was a business trust and, as such, it could in fact file for bankruptcy. In 1986, CCT consented to entry of an Order converting the case to a voluntary Chapter 11. Club Baha and Grobowsky then proposed a total liquidation plan as the Plan of Reorganization. That plan was confirmed, resulting in an in-kind distribution of the CCT assets to the trust beneficiaries.

It was against this background that the exculpatory clause came into play to absolve Respondents of all responsibility for their acts, which were just short of "proven dishonesty."

Second, the federal courts in this case clearly were not merely substitutes for state courts, blindly bound to follow state law. On the contrary, the cases are clear that issues of bankruptcy are federal questions, and that in particular, state law cannot frustrate or preempt federal bank-

ruptcy policy.[1] "[A]lthough state law governs substantive elements of the claim, its application always remains subject to countervailing federal bankruptcy policy." *Addison* v. *O'Leary*, 68 Bankr. 487, 491 (Bankr. E.D. Va. 1986).

Stated differently:

> While under federal bankruptcy law property rights of debtors and creditors are generally determined by state law, it is also true that where state law frustrates or burdens federal policy, state law must give way. [*In re Schnupp*, 64 Bankr. 763 (Bankr. N.D. Ill. 1986)].

Here, even if state law somehow conflicted with federal policy—and Respondents have not demonstrated that it did—federal policy would necessarily control. A federal court cannot be called upon to perpetrate a miscarriage of justice by allowing trustees in bankruptcy to engage in scandalous activities on the ground that "proven dishonesty" cannot be shown. The prevailing federal policy has to be that trustees in bankruptcy, accountable to the federal courts, are held to a higher degree of care than that.

Therefore, Respondents have helped demonstrate why this case is of paramount federal importance. By contending that state law controls, they have simply pinpointed the fact that federal courts acting pursuant to an Act of Congress—the Bankruptcy Code—cannot be called upon to sanction conduct that clearly violates every precept of federal public policy.

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[1] *E.g.*, *In re: Gambogi* v. *Capodalupo*, 20 Bankr. 587, 588 (Bankr. D.R.I. 1982); *In re: Warren* v. *Warren*, 7 Bankr. 201 (Bankr. N.D Ala. 1980); *In re: Environmental Research & Development, Inc.* v. *Resource Dynamics, Inc.*, 46 Bankr. 774, 775 (Bankr. S.D.N.Y. 1985); *In re: Spanish Trails Lanes, Inc.*, 16 Bankr. 304, 306 (Bankr. D. Ariz. 1981).

The Petition should be granted and the judgment reversed.

Respectfully submitted,

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